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No. 94-423

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In the Supreme Court of the United States

OCTOBER TERM, 1994

ROSEMARY S. KOVACS; LOIS E. KOVACS; KATHLEEN L. KOVACS, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether statutory interest received with respect to an award of damages for personal injury is excluded from income under Section 104(a)(2) of the Internal Revenue Code as "damages received * * * on account of personal injury" (26 U.S.C. 104(a)(2)).

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statement	2
Argument	5
Conclusion	9

TABLE OF AUTHORITIES

Cases:

Aames v. *Commissioner*, 94 T.C. 189 (1990)	4
Banish v. *City of Hamtramck*, 157 N.W.2d 445 (Mich. 1968)	6
Brabson v. *United States*, No. 93-K-2288 (D. Colo. Aug. 15, 1994)	6
Chouteau v. *Commissioner*, 22 B.T.A. 850 (1931)	7
Commissioner v. *Jacobson*, 336 U.S. 28 (1949)	5
Kieselbach v. *Commissioner*, 317 U.S. 399 (1943)	6-7
Kovacs v. *Chesapeake & Ohio Ry.*, 351 N.W.2d 581 (1984), aff'd, 397 N.W.2d 251 (Mich.. 1986)	3
McGraw v. *Parson*, 369 N.W.2d 251 (Mich. Ct. App. 1985)	6
Rice v. *United States*, 834 F. Supp. 1241 (E.D. Cal 1993), aff'd on other issues, No. 93-16272 (9th Cir. Sept. 7, 1994)	6
Riddle v. *Commissioner*, 27 B.T.A. 1339 (1933)	
Swift v. *Dodson*, 149 N.W.2d 476 (Mich. Ct. App. 1967) .	6
United States v. *Burke*, 112 S. Ct. 1867 (1992)	7
United States v. *Centennial Savings Bank*, 490 U.S. 573 (1991)	5
United States v. *Folckemer*, 307 F.2sd 171 (5th Cir. 1962)	7
Vannoy v. *City of Warren*, 182 N.W.2d 65 (Ct. App. 1970), aff'd,194 N.W.2d 304 (Mich. 1972)	6

Statutes and rule: Page

Civil Rights Act, Tit. VII, 42 U.S.C. 2000e-2(a)(1) 7
Internal Revenue Code (26 U.S.C.):
§ 61(a) 5
§ 61(a)(4) 5
§ 104(a)(2) 3, 4, 5, 7, 8, 9
Periodic Payment Settlement Act of 1982, Pub. L. No. 97-473, § 101(a), 96 Stat. 2605 ..... 4, 8
Mich. Comp. Laws (1987):
§ 600.2922 2
§ 600.2922(6) .....
§ 600.6013 ..... 2, 6
Sup. Ct. R. 10 .....

Miscellaneous:

R. Stern, E. Gressman, S. Shapiro & K. Geller, *Supreme Court Practice* (7th ed. 1993) 6
Rev. Rul. 76-133, 1976-1 C.B. 34 8
Rev. Rul. 77-230, 1977-3 C.B. 214 ..... 8, 9
Rev. Rul. 79-220, 1979-2 C.B. 74 8
Rev. Rul. 79-313, 1979-2C.B. 75 8
S. Rep. No. 646, 97th Cong., 2d Sess. (1982) 8

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-4) is unpublished, but the decision is noted at 25 F.3d 1048 (Table). The opinion of the United States Tax Court (Pet. App. 8-66) is reported at 100 T.C. 124.

JURISDICTION

The judgment of the court of appeals was filed on June 9, 1994. The petition for a writ of certiorari was filed on September 7, 1994. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. In 1976, Charles Kovacs died when the truck he was driving was struck by a locomotive operated by the Chesapeake & Ohio Railroad Co. On September 25, 1978, Rosemary S. Kovacs, the widow of Charles Kovacs and the administratrix of his estate, filed a complaint against the company under the Michigan Wrongful Death Act (Mich. Comp. Laws § 600.2922 (1987)). Pet. App. 10.

On May 28, 1982, a jury returned a verdict in favor of the estate, awarding damages for wrongful death in the amount of $1,500,000. The jury found the decedent comparatively negligent to the extent of 33 1/3 % which required the court to reduce the damage award to $1,000,000. The award was further reduced by $5,000 to reflect settlement of a claim against another party. The court therefore entered judgment for the estate in the amount of $995,000. Pet. App. 10. In addition, the court awarded interest from the date the suit was commenced (September 25, 1978), to the date of the judgment, in the amount of $360,777.41. The interest was added to the verdict under Mich. Comp. Laws § 600.6013 (1987), which at that time provided:

> (1) Interest shall be allowed on a money judgment recovered in a civil action, as provided in this section;
>
> (2) For complaints filed before June 1, 1980, in an action involving other than a written instrument having a rate of interest exceeding 6% per year, the interest on the judgment shall be calculated from the date of filing the complaint to June 1, 1980, at the rate of 6% per year and on and after June 1, 1980, to the date of satisfaction of the judgment at the rate of 12% per year compounded annually.

The trial court judgment was affirmed on appeal. *Kovacs* v. *Chesapeake & Ohio Ry.*, 351 N.W.2d 581 (1984), aff'd, 397 N.W.2d 169 (Mich. Ct. App. 1986). On March 17, 1987, the railway issued a check in the amount of $2,254,741.70 to Mrs. Kovacs as administratrix of the estate. That amount included the $995,000 in damages, $6,134.53 in costs and $1,253,607.17 in interest under Mich. Comp. Laws § 600.6013 (1987), calculated from the date the suit was commenced until the date the judgment was satisfied. Pet. App. 10-11.

Pursuant to an order of the trial court, Mrs. Kovacs received 66 2/3 % of the net proceeds of the check. Her daughters, Mary Ann Kovacs, Lois E. Kovacs, and Kathleen L. Kovacs, each received 11 1/9 %. Pet. App. 11.

2. Petitioners did not report any part of the amounts received from the judgment on their 1987 federal income tax returns. The Commissioner of Internal Revenue issued notices of deficiency asserting that petitioners had understated their income for the 1987 tax year by failing to include the interest portion of the award in their gross income. Pet. App. 11.

Petitioners sought review of the deficiencies in the Tax Court. They asserted that the entire amount they had received from the railway, including the statutory interest on the judgment, was properly excluded from gross income under Section 104(a)(2) of the Internal Revenue Code. That Section excludes from gross income "any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or sickness" (26 U.S.C. 104(a)(2)).

In a reviewed opinion, the Tax Court upheld the deficiencies (Pet. App. 9-22). The court noted (*id.* at 13) that, applying the established rule that statutes providing exclusions from income are to be narrowly

construed, it had consistently held that interest received in personal injury cases does not constitute "*damages* received * * * on account of personal injuries" within the meaning of Section 104(a)(2) (Pet. App. 15-17, citing *Aames* v. *Commissioner*, 94 T.C. 189 (1990); *Riddle* v. *Commissioner*, 27 B.T.A. 1339 (1933)). The court noted the distinction that its decisions had drawn between "damages," which serve to compensate for a wrong or injury, and "interest," which serves to compensate for a delay in payment (Pet. App. 14). The court observed (*id.* at 17-19) that the Michigan law under which interest was awarded in this case provides compensation solely for the delay in payment and not for the underlying personal injury itself.

The court rejected petitioners' argument that the Periodic Payment Settlement Act of 1982, Pub. L. No. 97-473, § 101(a), 96 Stat. 2605, requires exclusion of statutory interest under Section 104(a)(2). In amending Section 104(a)(2) in 1982 to provide that damages for personal injuries are to be excluded from income whether received "as a lump sum or as periodic payments" (26 U.S.C. 104(a)(2)), the Act did not specify that *any* element of recovery reflecting the time value of money is to be excluded from income (Pet. App. 20-22). The court concluded that, while the underlying award of $995,000 for wrongful death was excluded from income as damages for personal injury, the interest on that award was includable in gross income (*id.* at 14-17).

3. The court of appeals affirmed "on the basis of [the Tax Court] opinion and for the reasons stated therein" (Pet. App. 4).[1]

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[1] Mary Ann Kovacs did not appeal the Tax Court decision and is not a petitioner here.

ARGUMENT

The decision in this case is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore not warranted.

1. Gross income is broadly defined to mean "all income from whatever source derived" (26 U.S.C. 61(a)). In particular, "interest" is specifically included in gross income. 26 U.S.C. 61(a)(4). Under Section 104(a)(2) of the Internal Revenue Code, however, "the amount of any damages received (whether by suit or agreement and whether as lump sum or as periodic payments) on account of personal injuries or sickness" may be excluded from gross income (26 U.S.C. 104(a)(2)). The exclusion from income provided under Section 104(a)(2), like all other exclusions from gross income, is to be narrowly construed. See, *e.g.*, *United States* v. *Centennial Savings Bank*, 499 U.S. 573, 583-584 (1991); *Commissioner* v. *Jacobson*, 336 U.S. 28, 49 (1949). Two specific criteria must be satisfied for a taxpayer to qualify for this exclusion: (i) the amount received must constitute "damages" and (ii) the damages must be received "on account of" a personal injury or sickness. 26 U.S.C. 104(a)(2).

It is undisputed in this case that the principal award of $995,000 in damages for the wrongful death of Mr. Kovacs comes within the exclusion provided in Section 104(a)(2). The issue presented is whether the additional amount that petitioners received as statutory interest constitutes damages received on account of personal injury within the meaning of the statute.

The Tax Court has long held that the interest paid on a personal injury claim is not an element of damages received on account of personal injury but, instead,

represents compensation for the delay in payment. See Pet. App. 15-17.[2] Because exclusions from income are to be narrowly construed, other courts that have addressed this issue have reached the same conclusion. See, *e.g.*, *id.* at 4; *Rice* v. *United States*, 834 F. Supp. 1241, 1245 (E.D. Cal. 1993), aff'd on other issues, No. 93-16272 (9th Cir. Sept. 7, 1994).[3] See also *Kieselbach* v. *Com-*

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[2] Damages for wrongful death are awarded under Michigan law for medical expenses, pain and suffering, and loss of support and companionship (Mich. Comp. Laws § 600.2922(6) (1987)). By contrast, interest is awarded on such damages under a Michigan statute that provides simply for interest "on a money judgment recovered in a civil action" (*id.* § 600.6013). Interest under that provision is not compensation for the injury but is instead designed to compensate the plaintiff for the loss of use of the monetary damages. See *McGraw* v. *Parsons*, 369 N.W.2d 251, 254 (Mich. Ct. App. 1985). Statutory interest under Mich. Comp. Laws § 600.6013 (1987) accrues from the date the complaint was filed until the judgment is paid and is not a part of damages. *Vannoy* v. *City of Warren*, 182 N.W.2d 65, 69 (Mich. Ct. App. 1970), aff'd, 194 N.W.2d 304 (Mich. 1972); *Banish* v. *City of Hamtramck*, 157 N.W.2d 445, 451 (Mich. Ct. App. 1968); *Swift* v. *Dodson*, 149 N.W.2d 476, 478 (Mich. Ct. App. 1967).

[3] Petitioners err in contending that *Brabson* v. *United States*, No. 93-K-2288 (D. Colo. Aug. 15, 1994), is in "direct conflict" (Pet. 5) with these decisions. In *Brabson*, the district court concluded that "prejudgment interest is an element of damages compensati[on]" under Colorado law and that, under the specific provisions of that State's law, "is not 'interest' as that term is defined and generally understood" (Pet. App. 78). Michigan case law, however, makes clear that interest awarded on civil judgments is *not* "damages" but is "interest," which compensates the plaintiff for the delay in payment. See note 2, *supra*. In any event, the district court opinion in *Brabson* does not establish a conflict among the circuits that would warrant further review. See Rule 10 of the Rules of this Court; R. Stern, E. Gressman, S. Shapiro & K. Geller, *Supreme Court Practice* § 4.8, at 178-180 (7th ed. 1993).

missioner, 317 U.S. 399, 403-404 (1943) (interest component of condemnation award held not part of damages awarded for property, but indemnification for delay, and therefore taxable); *United States* v. *Folckemer*, 307 F.2d 171, 173 (5th Cir. 1962) (although bequest was nontaxable accession to wealth, interest thereon was taxable); *Chouteau* v. *Commissioner*, 22 B.T.A. 850, 857 (1931) (interest on judgment was taxable, although underlying damages were not taxable). There is thus no conflict of decisions to warrant further review in this case. See note 3, *supra*.

2. Petitioners contend (Pet. 5, 13-14) that the decision of the court of appeals conflicts "with the reasoning of" *United States* v. *Burke*, 112 S.Ct. 1867 (1992). In *Burke*, the Court held that back pay awards under the pre-1991 version of Title VII of the Civil Rights Act of 1964, 42 U.S.C. 2000e-2(a)(1), did not represent damages received on account of personal injuries and therefore were *not* excluded from income by Section 104(a)(2). See 112 S.Ct. at 1874. *Burke* did not involve the different question presented in this case, whether statutory interest on a civil judgment constitutes "damages" received on account of a personal injury. There is obviously no direct conflict between the Court's holding in *Burke* and the decision in this case.

Nor is the Court's reasoning in *Burke* inconsistent with the reasoning of the decision below. The language in *Burke* on which petitioners rely (Pet. 13-14) describes the types of damages that are typical in a tort action and states that damages related to both physical and nonphysical "personal injuries" are excludable under Section 104(a)(2) (112 S.Ct. at 1871 & n.6). Nothing in *Burke* provides any suggestion that statutory interest on a judgment constitutes "damages" received on account of a "personal injury." The determination of the

courts below in this case that interest awarded on a tort judgment is compensation for delay, not for a personal injury, has ample support (see note 2, *supra*) and is not contradicted by the reasoning or the holding of *Burke*.

3. Petitioners contend (Pet. 18-25) that the decision below misapplies the amendment to Section 104(a)(2) enacted in the Periodic Payment Settlement Act of 1982, Pub. L. No. 97-473, § 101, 96 Stat. 2605. That Act amended the statute to provide that the exclusion from income applies to "damages received (whether by suit or agreement *and whether as lump sums or as periodic payments*) on account of personal injuries or sickness." 26 U.S.C. 104(a)(2) (added language emphasized). The purpose of the Periodic Payment Act was to "provide statutory certainty" for the exclusion of personal injury damages that are paid in periodic payments, by codifying the position of the Internal Revenue Service that such periodic payments are excludable under Section 104(a)(2). S. Rep. No. 646, 97th Cong., 2d Sess. 4 (1982); see Rev. Rul. 77-230, 1977-2 C.B. 214; Rev. Rul. 79-220, 1979-2 C.B. 74; Rev. Rul. 79-313, 1979-2 C.B. 75; cf. Rev. Rul. 76-133, 1976-1 C.B. 34.

Petitioners did not receive periodic payments of damages. As the Tax Court correctly held (Pet. App. 20-22), the statutory language added by the Periodic Payment Settlement Act is therefore simply inapplicable in this case. Petitioners nonetheless contend (Pet. 19-22) that any interest added to an award of personal injury damages should be excluded from income under the amendment, regardless of whether it is in the form of a separate, statutory award or an (implicit) component of a periodic payment.

The Tax Court recognized (Pet. App. 21) that, in some but not all circumstances, a portion of a periodic payment of personal injury damages may represent the time value

of deferred compensation.[4] The fact that Congress elected to treat such periodic payments as non-taxable does not, however, alter application of the statute in contexts *not* involving periodic payments. As with all other statutory exclusions from income, the language added by the amendment to Section 104(a)(2) is to be construed strictly. The Periodic Payment Settlement Act reaches only periodic payments of damages and does not alter the long-standing rule that interest, stated and awarded separately from damages for personal injury, is taxable (Pet. App. 21-22).

There is, in any event, no conflict on this issue or other reason to warrant further review.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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[4] Some periodic payments of damages do not include an implicit "interest" component, for they relate to *future* medical expenses or pain and suffering. See, *e.g.*, Rev. Rul. 77-230, 1977-3 C.B. 214.